



Bill Analysis

Author: Grove

Sponsor:

Bill Number: SB 1203

Related Bills: See Legislative
History

Introduced February 15, 2024

SUBJECT

Education Flex Account Act of 2024

SUMMARY

This bill, under the Education Code (EDC) would create the Education Flex Account Act of 2024. This act would create a state-funded trust under which parents and guardians can request that an account be established for their children for tuition and expenses associated with education at an eligible school, as defined. Under the Personal Income Tax Law (PITL), this bill would provide a gross income exclusion for distributions from an Education Flex Account or Special Education Flex Account.

This analysis only addresses the provisions that would impact the Franchise Tax Board (FTB).

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to provide state funding for private elementary and secondary education expenses.

ANALYSIS

This bill, under the EDC and upon voter approval, would create the Education Flex Account Act of 2024. Under this program, funds would be disbursed to an eligible school on behalf of a student that is eligible for an Education Flex Account (EFA) or Special Education Flex Account (SEFA).

Under the PITL, for taxable years beginning on or after January 1, 2025, this bill would provide a gross income exclusion for distributions from an EFA or SEFA pursuant to a participation agreement.

This bill, under the EDC, would define and provide for the following:

- 1) Define an "Education Flex Account" and "Special Education Flex Account" to mean an account established under provisions added by this bill.
- 2) Provide that "participation agreement" has the same meaning as the term is defined in the EFA or SEFA, which means the uniform contract created by the EFA Trust Board that must be executed by the EFA Trust Board and the parent or legal guardian of an eligible student that directs the EFA Trust Board to disburse funds to an eligible school on behalf of the account beneficiary.

For purposes of complying with Revenue and Taxation Code (RTC) section 41, this bill would require the FTB to issue a report to the Legislature by July 1, 2026, and annually thereafter on the following:

- 1) The number of taxpayers that received distributions from an EFA or SEFA that but for this section, would have been included in income, and
- 2) The average dollar value of income excluded.

The disclosure provisions of this bill would be treated as an exception to the FTB's disclosure rules under Section 19542.

Effective/Operative Date

This bill would be effective January 1, 2025, and would only become operative if a Senate Constitutional Amendment is approved by voters at the statewide general election on November 5, 2024. If the Senate Constitutional Amendment is approved by voters, the gross income exclusion would be operative for taxable years beginning on or after January 1, 2025.

Federal/State Law

Gross Income

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Qualified Tuition Programs

Internal Revenue Code (IRC) section 529 (Section 529 Plan) provides tax-exempt status to qualified tuition programs (QTPs).

Contributions to a QTP must be made in cash. The Section 529 Plan does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions are not tax deductible for federal income tax purposes, but amounts earned in the account (i.e., interest) accumulate on a tax-free basis. Similar to federal law, state law provides that contributions made to a QTP are not deductible.

Distributions from a QTP are excludable from federal tax if used for the beneficiary's qualified higher education expenses. If a distribution from a QTP exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10% tax. Amounts in a QTP may be rolled over to another QTP for the same beneficiary or for a member of the family of that beneficiary.

For purposes of receiving a distribution from a QTP that qualifies for favorable tax treatment under the IRC, expenses mean qualified higher education expenses, qualified elementary and secondary education expenses, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance.

California generally conforms by reference to the federal rules related to state QTP rules under IRC section 529 as of the specified date of January 1, 2015 and does not conform to the federal definition for higher education expenses which include tuition expenses for elementary and secondary education.

Implementation Considerations

The FTB would have difficulty reporting on items that are excluded from income and not reported on the tax return. The author may want to consider whether the ESA Trust Board that makes the allocations would be better equipped to carry out the reporting requirements or require the ESA Trust Board to share information with the FTB for the purpose of making the report.

This bill would require the FTB to report on the number of taxpayers that received distributions from an EFA or SEFA. If the FTB provides the report, and if the author's intent is to be able to review a report that contains complete information for the 2025 taxable year, it is recommended that the reporting due date be extended to May of 2027. For instance, the due date for the 2025 personal income tax return is

April 15, 2026, and with extension individuals may file as late as October 15, 2026. The FTB needs approximately six months to complete return processing and to compile the needed data to prepare a report. As a result, it is recommended that the reporting due date be no earlier than May of 2027 to provide information for the 2025 taxable year. If the reporting due date remains unchanged, the report would include the information available as of six months prior to the date the report is due.

This bill uses undefined terms, "single filer" and "dual filers" within the definition of eligible student. Income limitations are generally applied to specific filing statuses. The absence of definitions could lead to taxpayer confusion. For clarity, the author may wish to amend the bill to define these terms.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 629 (Wallis, 2023/2024) would exclude from gross income a distribution from a qualified tuition program (QTP) to a Roth IRA. AB 629 did not pass out of the Assembly Appropriations by the constitutional deadline.

SB 292 (Grove, 2023/2024) would have created a state funded trust under which parents could establish an account for their children for tuition and expenses associated with education at an eligible school as defined. Additionally, this bill would have provided a gross income exclusion for trust distributions. S B 292 did not pass out of the Senate Education Committee.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1203 as Introduced February 15, 2024
Assumed Enactment after June 30, 2024

(\$ in Millions)

Fiscal Year	Revenue
2024-2025	\$0
2025-2026	-\$13
2026-2027	-\$13

*This estimate assumes the proposal is approved by voters at the statewide general election on November 5, 2024.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

LEGAL IMPACT

None noted.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

Senate Education Committee Analysis 04-22-2024.

Support:

- California Policy Center (sponsor)
- California Catholic Conference
- De La Salle High School
- Olive Knolls Christian School
- Protection of the Educational Rights of Kids
- Save Glendora Schools

Silicon Valley Association of Conservative Republicans
15 individuals

Opposition:

California Federation of Teachers
California Labor Federation
California School Employees Association
California State PTA
California Teachers Association

ARGUMENTS

Senate Education Committee Analysis 04-22-2024.

Proponents:

Proponents argue that these programs empower parents by providing them with choices about where and how to educate their children, and provide students, particularly at-risk or underserved students, with better education options. They also argue that free-market competition among public and private schools improves overall school quality through competition. Interestingly, some note that arguments in favor of school vouchers shifted over the years, with less discussion about the effects of vouchers on student achievement and more discussion about both the value of choice as a right in itself and the beneficial competitive effect of voucher programs on public schools.

Opponents:

Opponents argue that voucher programs divert public dollars to private schools, but without the same accountability or special education requirements as public schools. They express concerns that voucher programs divert motivated parents and students from underfunded public schools, leaving behind a larger number of disadvantaged students with fewer resources. Opponents also point out that it may be difficult for lower-income families to benefit from voucher programs, as the amount of money available through a voucher may not always cover the full costs of private school. Some raise concerns about public dollars funding religiously-affiliated private schools as a potential violation of the constitutional separation of church and state, as well as the potential for religious discrimination. Finally, some argue that these programs may potentially benefit only a small number of children without providing the comprehensive reforms needed to strengthen the entire public education system.

LEGISLATIVE CONTACT

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